

B. The IC Reflects the Recovery of Legitimate Costs Booked to Part 32 Accounts and Allocated to Interstate Transport by Parts 36 and 69.

1. LECs Must Assign Costs to Transport in Accord With the FCC Part 32, 36 and 69 Rules.

The initial basis for price cap LECs' transport rates were the Commission's Part 32, accounting,⁵¹ Part 36, jurisdictional separations, and Part 69, access cost allocation rules. These rules continue to serve as the basis for rate of return LECs' transport rates. LECs for several years have developed transport revenue requirements pursuant to the Part 36 and Part 69 rules. Under these rules, investments, reserves, expenses, and taxes are assigned or allocated to transport and other interstate access elements.

A general understanding of this cost allocation process and the resulting interrelationship of the costs (allocated by these rules for recovery) with the existing equal charge transport rates and the ordered interim rates, is essential to an understanding of the causes of the IC.

In general, costs (investments, expense, taxes and reserves) are first booked into the Part 32 accounts. Part 36 then utilizes these amounts for jurisdictional (interstate and intrastate) cost allocations. Under the Part 36 rules, costs are first categorized by function (i.e., trunk, switching, etc.). Next the categorized costs are generally allocated in a three step

⁵¹ Nonregulated costs, identified pursuant to the Commission's Part 64 rules are removed from Part 32 account balances prior to jurisdictional separation.

process: (1) direct investments are allocated based on a measure of use that is related to the function (switching minutes-of-use (MOU), trunk, etc.); (2) directly related costs (i.e., maintenance, depreciation, etc.) are allocated next based on the allocation of the direct costs; and (3) indirect or common costs (i.e., general support investments, corporate expenses, etc.) are allocated based on the combined allocation of groupings of already allocated direct and directly related investments or expenses.

In the categorization and allocation process, Part 36 rules require averaging of costs across all technologies and rate elements. Additionally, since separations, pursuant to Part 36, is performed for a state's (study area) total operations, costs are averaged for all markets (urban, rural, business, residence, etc.). Finally, Part 69 defines rules which assign all of the average interstate Part 36 costs to the access elements. Consequently, access rates such as interstate transport based on these costs are essentially study area or regional average rates (with the possible exception of special access) which make no distinction between technologies, markets or the degree of competition.

2. Costs Assigned to the IC and to Transport By SWBT Are Legitimate and Necessary For the Provision of Transport Services to All Markets Within SWBT's Study Areas.

As shown on Attachment 1, based on Part 32, 36 and 69 definitions and allocations, the following costs are included in the transport element: direct costs, which include return and income taxes associated with directly allocated net investment (tandem switching, message exchange trunk investment, interexchange trunk investment and other minor investment based costs such as

host/remote circuit equipment), directly related cost allocations (maintenance, depreciation, and property taxes related to the transport investments), and indirect cost allocations (e.g., general support facilities investment, corporate operations expense, etc.). Even though allocated to interstate transport on an average basis, the direct and directly related cost allocations reflect essential investments and expenses required to provide transport service to all customers which reside in a LEC's serving area. The LEC transport network is designed to serve all areas whether they are high traffic volume or low traffic volume markets, major cities or small towns. Indirectly allocated costs reflect essential costs that are necessary for providing support to all services (local, toll, and access).

Attachment 1 summarizes the costs assigned to the transport element for SWBT's operations. These costs were developed in strict conformance with the Commission's rules. As shown on Attachment 1, the total SWBT Transport revenue requirement is approximately \$395 million. That revenue requirement includes four essential components related to the provision of transport service: (1) Exchange trunk - \$108 million or 28% of the total revenue requirement; (2) Interexchange trunk - \$229 million or 58% of the revenue requirement; (3) Tandem Switching Costs - \$49 million or 12% of the total revenue requirement; and (4) Other - \$9 million or 2% of the total revenue requirement. The direct return and taxes for these facilities is 19% or \$75 million of the total transport revenue requirement. The directly related cost allocations are \$145 million or 37% of the total transport revenue

requirement. Other common and indirect costs allocated to transport by Part 36 and 69 rules are \$175 million or 44% of the transport revenue requirement.

3. Price Cap Transport Equal Charge Rates Were Initiated Based on These Legitimate Cost Assignments. These Rates Provided an Average Level of Contribution to Cover Part 36 and 69 Costs Allocated to Transport Irrespective of Technologies, Markets, etc., and Masked Support Flows From Low Cost Per Minute Transport Service Areas to High Cost Transport Service Areas. The New Lower Interim Rates Effectively Eliminate That Support Flow and Transfer it to the IC.

The cost assignments and allocations are closely scrutinized by the Commission and access customers. Price Cap LECs' cost calculations were subject to stringent criteria when they were under rate of return regulation, including the use of statistical criteria for evaluation of cost levels. The Commission chose to use rates based upon these costs as the initial price cap rates that were effective beginning January 1, 1991.⁵² Consequently, these costs represent the legitimate costs of providing telecommunications service that were assigned to interstate transport for recovery.

The Part 36 and 69 costs and associated rate levels are not appropriate for competitive market segments since they reflect the study area average (across service technologies and markets) allocation of costs to interstate access. These costs and rates also reflect the arbitrary choice of an average allocation for indirect and common costs to interstate transport. The costs

⁵² In the Matter of Policy and Rules Concerning Rates For Dominant Carriers, CC Docket No. 87-313, Second Report and Order 5 FCC Rcd 6786 (1990), at paras. 233 through 238.

developed pursuant to the Part 32, 36 and 69 rules are consistent with the average "equal charge" rate structure. Under the "equal charge" transport rate structure, average rates are based on the cost allocations described above, are charged per equivalent unit of traffic regardless of the geographic market area served, and the type or capacity of the transport facility involved. In other words, with this equal charge average rate structure, the same level of contribution to cover the average costs allocated per Parts 36 and 69 was extracted per minute. However, with competition, the same level of cost recovery or contribution cannot be extracted from all markets. Markets with significant levels of competition cannot sustain existing contribution levels that provide support to less competitive, high cost markets. The support flows from low cost to high cost areas that were masked by the average rates derived from the Part 36 and Part 69 processes are not maintained by the new interim rates. The new interim transport rate structure ordered by the Commission, which utilizes special access equivalent rates for transport (significantly lower than current equal charge rates) is designed to foster competition. The interim rates, however, essentially squeeze out legitimate cost support amounts currently being recovered through the equal charge rates.

C. The Size and Composition of the Interconnection Charge Reflects a Significant Loss of Contribution to Low Volume Market Areas, Indirectly Allocated Costs and Low Volume Tandem Costs.

Attachment 2 displays SWBT's current level of revenues applicable to the equal charge transport rate structure. Based upon SWBT's applicable equal charge rates, approximately \$328 million of revenue is expected for the current July 1, 1992 through June 1993 tariff period.⁵³ As shown under "Current Structure" on Attachment 2, this amount is actually \$67 million less than the total \$395 million 1992 transport revenue requirement allocated by Parts 36 and 69. The \$67 million shortfall, as noted on Attachment 2, is recovered in other rate elements now allowed under price caps.

Attachment 2 under the heading "Interim Transport Structure" also shows an estimate of revenues expected from the interim transport rate structure ordered by the Commission, of approximately \$64 million. SWBT's estimate of the IC revenue amount is approximately \$264 million, which represents the difference between the current equal charge revenue and the interim structure revenue.

The size of the IC (approximately 81% of the current transport revenue) has led some to allege that these revenues and their underlying costs, allocated by Parts 36 and 69, are somehow inappropriate. This simply is not the case. As shown previously, the cost basis for the current transport rates and revenues are the

⁵³ (assumes 1991, base period, demand)

booked interstate investments and expenses which are allocated to interstate transport service by Parts 36 and 69.

The IC poses two major questions - (1) what causes it/what are its components, and (2) how to deal with it. The causes must be identified before any comprehensive method to deal with the IC can be addressed. In other words, an understanding of the components which cause the IC can then be utilized to develop and implement appropriate solutions. The IC cannot, as has been assumed by some, simply be phased out. Instead, a number of solutions will be required.

In an extensive study, SWBT has identified four major areas of costs that are not recovered in the interim structure's rates, but instead are recovered from the IC. These components are shown on Attachments 3 and 4 and include: (1) contribution lost under the interim rate structure from high volume areas to offset interexchange and exchange trunk direct and directly related facility costs associated with serving low volume/high cost areas which encompass many rural serving areas in SWBT; (2) contribution lost under the interim rate structure to offset costs associated with common or overhead costs which are necessary to provision all services (only shown on Attachment 4); (3) contribution to offset eighty percent of the interstate tandem switching costs; and (4) overallocation of GSF costs to transport. Attachment 3 provides an overview of the IC components while Attachment 4 provides further detail regarding their make up. In the following section, SWBT provides a detailed discussion of each of these components and how they were quantified.

1. Lost Contribution From High Volume/Low Cost Areas to Offset Costs Associated With Serving Low Volume/High Cost Areas.
 - a. A Significant Share of SWBT's Transport Routes and Costs Are Devoted to Providing Connectivity to Rural and Low Volume Service Areas.

SWBT's switched transport network provides connectivity between all towns, cities, and rural areas within Local Access and Transport Areas (LATAs) in Arkansas, Kansas, Missouri, Oklahoma, and Texas. Rural and low volume market areas comprise a major portion of SWBT's service territory. Transport service is provisioned by providing an access customer connections to a central office, usually referred to as the serving wire center. From that serving wire center a customer can gain access to the exchange served by that serving wire center or any end office that is interconnected with it. Based on December 1992 interstate access billing demand data, SWBT along with independent telephone companies within its territory provided switched transport service from 454 serving wire centers to 3,304 end offices. This represents 9,685 unique serving wire center to end office routes for which transport services are provided. As shown on Attachment 5, a significant portion, approximately 85% of these routes transport traffic to SWBT offices and independent company offices located predominantly in non metro and rural areas. Only 15% of the routes provide service within metro areas, which likely will be initially subject to increased competition. More significantly, Attachment 5 shows that a very small percentage, approximately 13%, of SWBT metro and non metro routes carry a significant share, approximately 91%, of the transport minutes. The remaining 87% of

below average transport routes carry well below average transport minute of use volumes, only 9%.

The costs allocated to interstate transport by Parts 36 and 69 and the current equal charge rates make no distinction between metro or non metro and high or low volume service areas. This was consistent with the equal charge rate recovering the same average costs for all transport routes. However, the Commission has established the interim rates at a level (much lower than the equal charge rates) which is more appropriate in areas where significant transport competition is likely (i.e., metro areas). Unfortunately, those high volume metro areas were providing substantial revenue contribution, under the equal charge rates, to the low volume metro and non metro, rural routes, but now must provide that contribution in the IC, not the common and direct trunk charge.

Volumes vary substantially by route depending on the demographic nature of the serving area. As shown on Attachment 5, volumes for transport services to offices within metropolitan areas and some suburban areas are high due to the higher population densities and concentration of businesses in these areas compared with small towns and rural areas.

b. Analysis of the Costs to Provide Service to Rural and Low Volume Service Areas Shows That Revenues Necessary to Provide Service Are Lost Under the Interim Rates and Transferred to the IC.

In order to further analyze the contribution provided by high volume to low volume transport areas under the equal charge

rates and the loss of that contribution under the interim rates SWBT performed an extensive study which is described below.

(1) Costs Are Substantially Higher In Low Volume Service Areas - Attachment 7.

Transport Circuit and Cable and Wire Facility (CWF) interstate costs (direct, directly related and indirectly allocated) were associated with end office and tandem switch service locations and then segregated by transport volumes. This study was performed separately for transport circuit and CWF costs associated with all of end offices and tandems. Attachment 6 shows the results of this phase of the study. Very clearly, the cost per minute for SWBT's transport services varies dramatically with usage volumes. The end offices and tandem offices with large volumes produce costs per minute that are much lower than offices with smaller volumes. SWBT's highest volume offices have an approximate cost per minute of \$.002040 compared with a cost of \$.020286 for the lowest volume offices which is almost a ten fold difference. There are only 80 high volume/low cost end offices (over 100M annual minutes). The remaining 1144 end offices have lower volumes and higher costs. Attachment 6 also shows that while the majority of tandems are high volume offices, (approximately 37 offices) (annual minutes over 100M), 24 of these high volume offices, have higher than average costs since they serve a significant number of low volume/high cost end offices. Attachment 7 displays the high and low volume service and cost characteristics associated with tandem offices.

(2) Equal Charge Average Rates Caused
Significant Contribution to Flow From Low
Cost Per Minute Service Areas to Higher
Cost Per Minute Service Area -
Attachments 8 through 11.

Existing contribution under the equal charge rates from high volume/low cost areas defined above to low volume/high cost areas, also defined above, was developed. The equal charge rate structure, as stated previously, is based upon average rates per minute of use which are applicable to all transport minutes. Under the equal charge structure, average rates are charged to customers, regardless of the particular area served (high or low volume, metro or non metro, urban or rural). Consequently, high volume traffic areas help to recover a large share of transport costs which serve to support charging average rates for low volume/high cost areas. On Attachment 8, the average equal charge revenue is calculated for end office and tandem transport serving areas (See Columns A through C). This revenue by groupings of serving areas is then compared with the cost or revenue requirement for the same serving area (Column D). As can be seen in Column E, the high volume end offices (Rows 1 and 2) and tandem service areas (Rows 7 and 8) (volumes above the average volume) provide substantial revenue contribution (approximately \$57 million - Rows 14 and 15, Column E) to offset the higher cost of low volume end office and tandem service areas. In other words, under the current equal charge rate structure, a small number of high volume/low cost (largely metro) transport service areas contribute substantial amounts of revenue to offset the substantial number of high cost/low volume service areas. This contribution currently insures that customers in the

low volume (largely non metro and rural) service areas have connectivity to the toll network. The equal charge revenue and the revenue requirement, necessary to provide service to high and low volume areas, are also shown graphically by end offices, tandem and in total on Attachments 9, 10 and 11, respectively.

These attachments clearly show that the average equal charge rate (converted to an average charge per minute of use) previously in place for transport was set at a level which allowed the recovery of facility costs necessary to serve all exchanges within SWBT's study areas. These average rates obscured the fact that SWBT has a substantial number of low volume/high cost markets in each study area which were supported by contributions from high volume/low cost markets.

As can be seen, SWBT has a substantial number of rural and other low volume transport market areas whose cost per minute is substantially above the average. Clearly, these high cost areas are supported by contributions from metro office transport market areas with above average usage. In other words, if the rates had been deaveraged under the current transport structure, rates for metro office transport areas could have been lowered because of their high volume of usage while rates for low volume office market areas would have been raised.

(3) Substantial Contribution Which is Necessary to Provide Service to Higher Cost Service Areas is Lost Under the Interim Rates and Transferred to the IC - Attachments 8 through 12.

The lost contribution resulting from the use of the ordered interim transport rates was developed for high and low volume areas. On Attachment 8, the average interim rate was used to develop the interim rate revenues (Columns F and G). The contribution lost by service areas (Column H) was then simply developed by subtracting the interim revenue by service area from the equal charge revenues. The interim rate revenues by serving areas are graphically shown on Attachments 9, 10 and 11 for end offices and tandem locations and in total. The lost contribution, of approximately \$182 million, (Attachment 8, Row 19, Column H) reflects the loss of the current equal charge revenue contribution and a shortfall in cost recovery. Finally, on Attachment 12, the total lost contribution resulting from the interim rates (segregated between direct plus directly related cost allocation and indirect cost allocation) is shown.

The study shows that the use of the interim transport rate (based on special access) for transport may be more appropriate in the competitive transport market areas, with higher volumes, which have characteristics like special access. However, when these high volume rates are used for all transport market areas, including the low volume and rural areas, \$182 million in support flows or contribution, (\$126 million in direct and directly allocated costs and \$56 million in indirect cost allocations - Attachment 12) previously inherent in the higher average equal

charge rates is eliminated. This \$182 million is transferred to the IC.

Clearly, as shown in SWBT's analysis, the interim transport rates do not generate sufficient revenue to recover the embedded costs of the facilities necessary to serve the low volume transport market areas. As shown on Attachment 6, Column G these areas do not produce 9000 minutes of use per equivalent voice grade circuit per month. Therefore, the use of 9000 minutes, which underlies the interim rate structure, insures an underrecovery of the cost of facilities for these areas which is then assigned to the IC.

c. Part 36 and 69 Defined Cost Differences Between Special Access and Transport, As Well As, Devaluation of Transport Investment Under the Interim Rates Contribute to the Size of the IC.

In addition, as shown on Attachment 13, the differing assignment of costs in Part 36 and Part 69 to special access and transport, due to differences in provisioning, contribute to the IC. Special access includes largely short haul high volume facilities normally within metro areas, exchange trunk special access and all wideband facilities. Transport, on the other hand, includes the majority of long haul interexchange trunks and all tandem switching costs.

The revised rate structure, which furthers the Commission's competitive goals, assumes a high volume network provisioned with new technologies. The transport rates established therein implicitly assume a level of direct costs, directly related

expenses and indirect allocations (overheads) that can be recovered.

However, this new rate structure, as described in previous sections, does not incorporate the following legitimate business costs associated with the existing telecommunications network:

- Mix of older, higher cost technologies actually used to provide service (i.e., devalued⁵⁴ investment)
- Costs associated with devalued technologies (i.e., higher maintenance costs and loss of efficiencies that would be obtained with new technologies)
- Higher overhead levels applied based upon higher investment base (i.e., mix of older technologies has higher original cost than new technologies)

Consequently, the current actual and legitimately assigned levels of net investment, directly related cost and indirect allocations are greater than the recovery levels provided by the revised transport rate. Therefore, the new transport rates result in an underrecovery of actual and legitimate costs, which must then be incorporated into the IC element for recovery. The problems associated with recovery of embedded investment (i.e.,

⁵⁴ The term "devalued"/"devaluation" as used herein means the condition (i.e., exclusion of legitimate costs) posed by changes in the interim transport rate structure. Devaluation is defined as the difference between Parts 36 and 69 allocated net investment less net investment supported by the new interim rate structure. The term devalue/devaluation should not be misconstrued as an attempt to alter original cost of an asset for book purposes, nor as a mechanism for recognition of "Asset impairment" in accordance with FASB 101. Any such attempt (i.e., to alter original cost of investments) would require revisions to Part 32 Accounting Rules (i.e., specifically the provision that requires investments to be recorded at original cost).

older higher cost technologies) will continue to occur as a result of technological advancements and increased competition.

In summary, as shown in SWBT's study, \$182 million in revenue (\$126 million in direct and directly allocated costs and \$56 million in indirect cost allocations) is transferred to the IC due to lost contribution to low volume/high cost transport service areas along with differences in costs underlying the interim rates and those actually assigned to transport. The embedded investments and associated costs reflected by the IC revenues are essential for the provisioning of universal access to the toll network by all customers (high and low volume, urban and rural) and therefore, the Commission must maintain the IC, recognize the legitimate costs associated therein, and provide SWBT the flexibility of alternative solutions for cost recovery.

2. Lost Contribution to Common and Overhead Costs Accounts For \$56 Million of the Interconnection Charge.

As discussed in preceding sections, Parts 36 and 69 assign indirect (common or overhead) costs to interstate and transport in a general and arbitrary manner. The implicit assumption was that the average transport rate, established based on the direct, directly related and indirect cost allocations, could be sustained and would provide contributions to recover these overheads.

Overheads are assigned to the interoffice trunk categories based on gross embedded investment. Once categorized, overheads are assigned by Part 36 and 69 to special access and transport in an entirely different manner. Overheads are

essentially assigned to special access on a fixed basis (i.e., per circuit, per circuit mile, per loop, etc.) while overheads are assigned to interstate switched transport on a per minute-of-use basis. The greater the minutes, the greater the overhead assignment.

With the introduction of competition, and the revised pricing structure for transport, the average overhead allocation assigned to interstate transport by Parts 36 and 69, and recovered under the equal charge rates, is not recoverable under the lower interim rates. The unrecoverable amounts, or lost indirect cost contribution by serving area within SWBT, is shown on Attachment 12. The indirect costs in total, as booked in Part 32, are necessary to support all interstate and intrastate services. The problem encountered with the IC is that the lost indirect cost contribution represents a mismatch in the Part 36, 69 allocation of these costs, their recovery under equal charge rules, and the level which is recoverable with the interim rate structure imposed by the FCC for transport.

3. Lost Contribution to Tandem Switching Costs.

The Commission requested comments regarding the portion of tandem costs that should be paid by tandem transport users and requests quantification of these amounts.⁵⁵ The Commission has initially concluded that most of the tandem revenue requirement is attributable to tandem switched transport. The Commission, however notes that the tandem revenue requirement includes SS7 call set-up costs, which benefit both direct trunked and tandem-switched

⁵⁵ FNPRM, at para. 132.

transport users.⁵⁶ The interim rate structure adopted by the Commission recovers 20 percent of the tandem costs from tandem transport users and the remaining tandem costs through the IC which will apply to all transport users.⁵⁷

SWBT has deployed numerous tandem switching facilities to provide for network connectivity. In addition to providing for interconnection with its own switching offices (small and large), SWBT has placed tandem facilities to provide for connectivity to independent LECs.⁵⁸ Consequently, tandems serve high volume and low volume areas, as shown on Attachment 7. To maintain ubiquitous connectivity these costs will continue. In low volume traffic areas, common transport/tandem switched services are generally the most economical means for carrying traffic. Dedicated facilities may be cost prohibitive.

SWBT, based on January through August, 1992 data, estimates that its total annual interstate tandem switching revenue requirement is approximately \$48.8 million. This total includes approximately \$5.8 million of revenue requirement related to SS7 switching equipment, which provides signalling for tandem switching and other functions. Thus, approximately \$43.0 million of the tandem switching revenue requirement is directly attributable to tandem switched transport. These interstate revenue requirements were identified utilizing cost allocation methods contained in the

⁵⁶ Interim Transport Order, at para. 25.

⁵⁷ Interim Transport Order, at para. 25.

⁵⁸ As shown in Attachment 5, approximately 49 percent of SWBT's current transport routes serve independent company exchanges. These are provisioned primarily through tandem offices.

Commission's Parts 36 and 69 Rules. The 80% of the tandem switching revenue requirement assigned to the IC is the \$39 million (\$48.8 million x 80%) shown on Attachments 3 and 4.

These tandems serve not only high volume competitive markets and exchanges where the 20% recovery may be appropriate, but low volume/high cost exchanges. The cost of tandems to serve the low volume exchanges is reflected in the 80% of the costs assigned to the IC.

SWBT cannot exit the low volume markets served by the tandems, nor do they wish to do so. However, to serve these markets, recovery of the additional tandem costs not covered by the interim tandem charge is required. Tandems are essential for both tandem switched and direct trunked customers. Even with the new transport structure, direct trunked customers will purchase overflow usage on a tandem switched transport basis. As discussed previously, SWBT believes that recovery of all switching related costs currently assigned to tandem switching should be moved from the transport basket to a new switching basket. With this move, SWBT and other LECs must also have the flexibility to establish switching rate elements, including a tandem switching charge, to recover these costs from the cost causer. If this does not occur, mechanisms described in the solutions section for low volume/high costs can be employed to recover the lost contribution for tandem-switched costs. However, in the interim until that is accomplished, the current IC mechanism must remain in place to provide for recovery of these costs, which are necessary to provide transport connectivity for all market areas (high and low volume),

from these services. Modifications, if necessary, to jurisdictional allocation of SS7 costs and other tandem costs, should be referred to a Joint Board for resolution.

4. Part 36, 69 Cost Misallocation or Allocations Which May Be Inappropriate in Light Of The Interim Transport Rate Structure Account for \$43 Million of the IC.

Several potential cost misallocations have been identified in the process of this and other proceedings currently under investigation. Only the allocation of General Support Facilities has been targeted for specific resolution in the current proceedings, but other cost misallocations contribute to the difference between the fully distributed costs using FCC Part 36 and 69 and the more economic approach being taken with the interim transport prices in the current competitive environment.

a. General Support Facilities

As discussed in CC Docket No. 92-222, a major example of a cost misallocation is the treatment of General Support Facilities.⁵⁹ If allocated in a more appropriate manner, approximately \$43 million would be removed from the transport category and the IC (See Attachment 14). This Part 69 change regarding the reallocation of GSF will also remove costs from the special access and local switching access cost categories. Approximately \$90 million in costs removed from other access

⁵⁹ In the Matter of Expanded Interconnection with Local Telephone Company Facilities; Amendment to Part 69 Allocation of General Support Facility Costs, CC Docket No. 92-222, Report and Order and Notice of Rulemaking (released October 14, 1992).

categories will be assigned to the common line category.⁶⁰ SWBT supports this change on an interim basis and suggests a restructure of access rates to recover the cost shifts among access elements. The effect of this restructure would reduce the IC, and other non common line access rates. For common line, the shifts would result in increased Subscriber Line Charge (SLC) rates to the caps, if below the caps, and increases to originating and terminating CCL.

In the longer term the cost transferred to common line, should be recovered on a non-MOU basis. This could be accomplished by increasing the single line SLC cap or by creating a new flat rate element. This more appropriate recovery method should be explored in a comprehensive review.

b. Other Possible Inappropriate Cost Allocations Contribute to the IC.

As previously discussed, Parts 36 and 69 are premised on study area average cost allocations. Directly related expenses are allocated in proportion to the direct average allocation. Indirect costs are then allocated on an overall average basis. Previously, the interstate access rate structure generally recovered these Fully Distributed Costs (FDC) costs on an average basis. Consequently, the average nature of the allocation and the selection of an "arbitrary" overhead allocation level was not a major concern.

Instead, the major concern in prior revisions to Part 36, was primarily the size of cost shifts between jurisdictions, not the effect on access categories. However, as the Commission

⁶⁰ See, SWBT Comments and data filed in CC Docket 92-222 on December 4, 1992.

strives to introduce new competition in the telecommunications market, which effectively eliminates the concept of averaged rates, the existing Part 36 and 69 cost allocators may be inappropriate in that the interim rate structure, if left unchanged, and the IC, especially if it is phased out, will not support the current cost allocation level. It is clear that the implicit costs underlying the interim switched transport rates are much lower than the current average Part 36/69 allocations of direct, directly related and indirect costs. This mismatch contributes directly to the size of the IC.

Parts 36 and 69 are replete with examples of possible distorted allocations in light of the interim rate structure. Parts 36 and 69 were not designed to appropriately allocate costs by technology, rate element and market to enable competitive prices to be established or to distinguish between competitive and less competitive markets. Parts 36 and 69 are merely regulatory imposed averaging methods of allocating all costs irrespective of technological, rate element, market, competitive, etc., differences. Changes could possibly, if implemented, result in a more appropriate level of cost allocations to interstate and to access in light of the new rate structure.

SWBT does not believe that the solution to the IC dilemma can be resolved by relying primarily on cost changes other than the GSF change, but instead believes that the solution should be based on an appropriate level of pricing flexibility required by particular market conditions; that is, pricing flexibility sufficient to participate fairly in competitive areas as well as

being able to recover costs to serve the aforementioned low volume areas. If however, these proposed solutions are not adopted by the Commission, Part 36 and 69 cost allocations should be evaluated in a Joint Board proceeding, subsequent to a comprehensive review.

Part 36 changes, which would solve the mismatch of the interim transport rates and the current interstate transport cost assignments, will also remove costs from access elements including transport and will move interstate costs closer to those implicitly assumed to be recoverable in the revised access rates. However, it is very likely that these costs removed from interstate access and transport will be largely shifted to the intrastate jurisdiction for recovery. If this approach is taken, the LECs and the state regulators will be left with the unenviable task of revising intrastate rate structures to recover the interstate lost contribution resulting from the interim transport rates. At the same time, in the state jurisdiction, the state access rates will likely be under review to determine if they should be restructured to mirror the new interim structure. This may result in intrastate lost contribution.

In short, Part 36 changes could be considered in a comprehensive review, however, due to the significant shifts of costs to the intrastate jurisdiction which are likely, SWBT believes that other mechanisms such as interstate pricing flexibility, interstate capital recovery and/or interstate public policy support are more appropriate to consider.

V. SOLUTIONS TO THE INTERCONNECTION CHARGE RECOVERY DILEMMA

SWBT has established the legitimacy of the IC and explained its major components. Time will now be needed to evaluate options involving possible solutions to the problems presented by the interim rate structure which caused the IC. Discussed below and summarized on Attachment 15, are a set of possible solutions which could resolve the problem presented by the IC. However, these solutions, and those presented by others, should be thoroughly evaluated before any action is taken which would reduce the contribution to low volume/high cost service areas. Only after these solutions are evaluated and implemented as a result of further proceedings can the IC be reduced. In short, the IC should not be phased out as suggested by the Commission, but should be reduced or replaced only as the solutions, as outlined below, are implemented.

SWBT's approach to replacing the IC in a comprehensive manner would first disaggregate the IC into components, comprised of the following: (1) the GSF change proposed in CC Docket No. 92-222; (2) lost contribution to the higher cost of serving low volume areas; (3) lost contribution to indirectly allocated costs necessary to serve all areas; and, (4) lost contribution to tandem switching costs. The different Options described below would then provide for recovery of these lost contributions and the GSF misallocation using combinations of the following mechanisms: (1) the Part 69 GSF cost allocation change; (2) more economically efficient pricing policies than those adopted in the interim transport structure; (3) capital recovery reform; and, (4) public

policy support mechanisms. A summary of the Options is provided as Attachment 15. These Options are applicable to CWF, Circuit and tandem costs. However, tandem may not need to be dealt with under these Options if its costs are moved to and recovered in a new switching basket.

A. Option 1 - The Most Economically Efficient (and least costly) Solution.

Option 1 includes adoption of Part 69 GSF cost allocation changes and implementation of economically efficient pricing policies. The first action required in this Option is the adoption of the Part 69 GSF cost allocation changes as proposed by SWBT in its Comments and Replies in CC Docket No. 92-222. This change would provide for interim recovery of the costs shifted to the common line element through a rate restructure. This would also result in an immediate decrease in the IC. In the longer term, the costs shifted to the common line element should be recovered on a non-MOU basis. This recovery could involve an increase in the single line SLC cap or a new flat rate element. These longer term changes should be evaluated in a comprehensive review.

The second part of this Option would involve both the LECs and the IXC's in a joint effort to continue provisioning of universal access to the telecommunications network. It would require the continuation of interstate nationwide average toll rates to the end user. SWBT, as well as other LECs, would be allowed to price transport services on an economically efficient basis.